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Secretary  
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RE: Docket No. R-1564

Dear Ann:

The Federal Reserve's Retail Payments Office ("RPO") is pleased to offer the following comments on the proposed amendment to Regulations CC to address situations in which there is a dispute as to whether a check has been altered or is a forgery, and the original check is not available. The Board's proposed rule would adopt a presumption of alteration when a dispute turns on the issue of whether an image or copy is derived from an altered check or from a check issued over a forged drawer's signature. The regulatory change is necessary because the widespread adoption of image based check collection and return (together with the generally accepted industry practice of destroying original checks after they have been image captured) has created judicial inconsistency and hence industry uncertainty about the allocation of liability that results when a check has been altered, versus the liability that results when a check has been issued over a forged drawer's signature. The UCC generally makes a paying bank liable if it pays a check that was not authorized by the account holder but generally makes a transferring bank liable for an altered check. Recent appellate court decisions have reached conflicting outcomes in applying the UCC to the case of imaged items when the original check has been destroyed and thus there is no forensic evidence to prove whether an item was altered or forged. The result of the proposed amendment would generally be to place liability ultimately on the depository bank rather than on the paying bank when there is a dispute whether an item has been altered or forged and the original check is not available. In general, the RPO supports the proposed presumption of alteration. The RPO believes that the creation of the proposed evidentiary presumption will effectively resolve the uncertainty that has arisen about the allocation of liability, and that the allocation of liability ultimately to the depository bank is the most efficient choice in the absence of evidence that proves an item was issued without the account holder's authorization.

Although we are generally supportive of the proposed amendment, we offer the following suggestions for the Board's consideration.

1. Although the scope of possible alterations could extend to any information or data on a

check image or in the associated records in the image file format, the Board's proposed rule would create a presumption of alteration only if the payee, the amount, or possibly the date has been altered. If the Board means the proposed new rule to leave the substance of existing check law intact and simply to create a new evidentiary presumption to resolve the uncertainty around which bank will be liable when there is a dispute whether an item has been altered or was "forged," it is not clear why the Board is proposing a wholly new meaning for an alteration, which is much narrower than the definition of "alteration" in UCC 3-407. The UCC definition includes an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or an unauthorized addition of words or numbers or other change to an incomplete instrument. Even the UCC definition is, if anything, too narrow if the concept of an alteration is meant to include any of the changes that a bad actor might introduce into a check, an electronic check, or a substitute check for the purpose of committing fraud. The operational reality is that fraud could be committed by artifices involving an alteration of the name of the payee, the amount, the date, the check number, the routing number encoded on the check or in the related records, the drawer's account number, the image survivable security features, the payee's indorsement, a bank's indorsement, or any other informational or data element that is used operationally to process, post, transfer, present, or return an item. If the Board adopted the amendment to Regulation CC as proposed, we are concerned that instead of creating a simple outcome in which an image or copy is presumed to be altered if there is no proof of "forgery" at issuance, the new rule would create a complex outcome, in which it would be unclear which bank bears the liability if there were a dispute about whether the original check was "forged" or there had been an alteration of one of the informational elements not covered by the evidentiary presumption in amended Reg CC. In our view, the most efficient solution would be to maximize the scope of the presumption of alteration. Thus, in section 229.38(i), where the currently proposed language says "...the presumption in this paragraph applies with respect to any dispute ...as to whether –(i) the dollar amount or the payee on a substitute check or electronic check has been altered....", we propose the following language: "...the presumption in this paragraph applies with respect to any disputeas to whether –(i) the original check or the electronic check or substitute check was altered after the original check was issued...." Our proposed language would address the entire scope of the current legal uncertainty, while the Board's proposed language addresses only a subset of that uncertainty. If the Board were to finalize its rule as proposed, there will continue to be some cases in which neither the UCC nor Reg CC provides a single clear answer as to which bank is liable. We respectfully suggest that to create an efficient outcome that minimizes uncertainty and the litigation costs that result from uncertainty, the final rule should dictate only two possible outcomes—either there is evidence to prove that the item was "forged" (i.e. not properly authorized by the drawer) at issuance, or the item will be presumed to have been altered. To accomplish this end, Regulation CC would not need to depart from the UCC definition of an alteration.

2. There is much to like in the Board's use of plain English in proposed section 229.38(i), which distinguishes between an item that has been altered and an item that is forged. But the use of plain English comes at some cost. Although *Price v. Neal* specifically

concerned a forged drawer's signature, and it is often said that the payor bank is liable for items that it has paid over forged signatures, the "rule of Price v. Neal" has become more broad than that. Under the UCC, the payor bank is generally liable for paying a check, the issuance of which was not authorized by the accountholder, whether there is a forged drawer's signature on the check or not. We believe that it might be useful to move away from the plain English but under inclusive phrasing used in the proposed rulemaking—"the substitute check or electronic check is derived from a check that is a forgery"—to alternative phrasing that covers the entire scope of the payor bank's liability for paying an item that is not properly payable because the accountholder has not authorized the issuance of the item—hence something like "the substitute check or the electronic check is derived from a check that was issued without the account holder's authorization."

3. Finally, we note that the Board's proposed rulemaking contemplates two ways in which the new evidentiary presumption would become inoperative. If the original check is made available to all parties in a dispute, then under the Board's proposed rulemaking, the presumption set forth in 229.38(i) would not apply. In addition, the Board's proposal would make the evidentiary presumption rebuttable—"The presumption of alteration may be overcome by proving by a preponderance of the evidence that either the substitute check or the electronic check accurately represents the dollar amount and the payee as authorized by the drawer, or that the substitute check or the electronic check is derived from an original check that is a forgery." We agree that the production of the original check should overcome the evidentiary presumption in proposed section 229.38(i), because the original check ought to provide forensic evidence sufficient to prove whether the item was issued without the accountholder's authorization or was altered after issuance. But we respectfully question whether it would be more efficient to create a stronger evidentiary presumption in favor of alteration when the original check cannot be produced. If the Board adopts an evidentiary presumption that is rebuttable even without the production of the original check, parties are going to continue to expend resources litigating the issue of whether an item is an alteration or a forgery. As a matter of efficiency, we believe that the Board should consider whether to make the evidentiary presumption stronger and simpler. We believe that the most efficient rule would be that the proposed evidentiary presumption can be overcome only by producing the original check.

The RPO appreciates the opportunity to provide comments for the Board's consideration. The RPO strongly supports the general direction of the Board's proposed rulemaking. The proposed rule will certainly result in an improvement over the current state of legal uncertainty.

Sincerely,



Marie Gooding

CC: Cheryl Venable  
Richard Fraher